ROTTERDAM SCHOOL OF MANAGEMENT
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DEPARTMENT OF FINANCE

The Value of Offshore Secrets: Evidence from the Panama Papers

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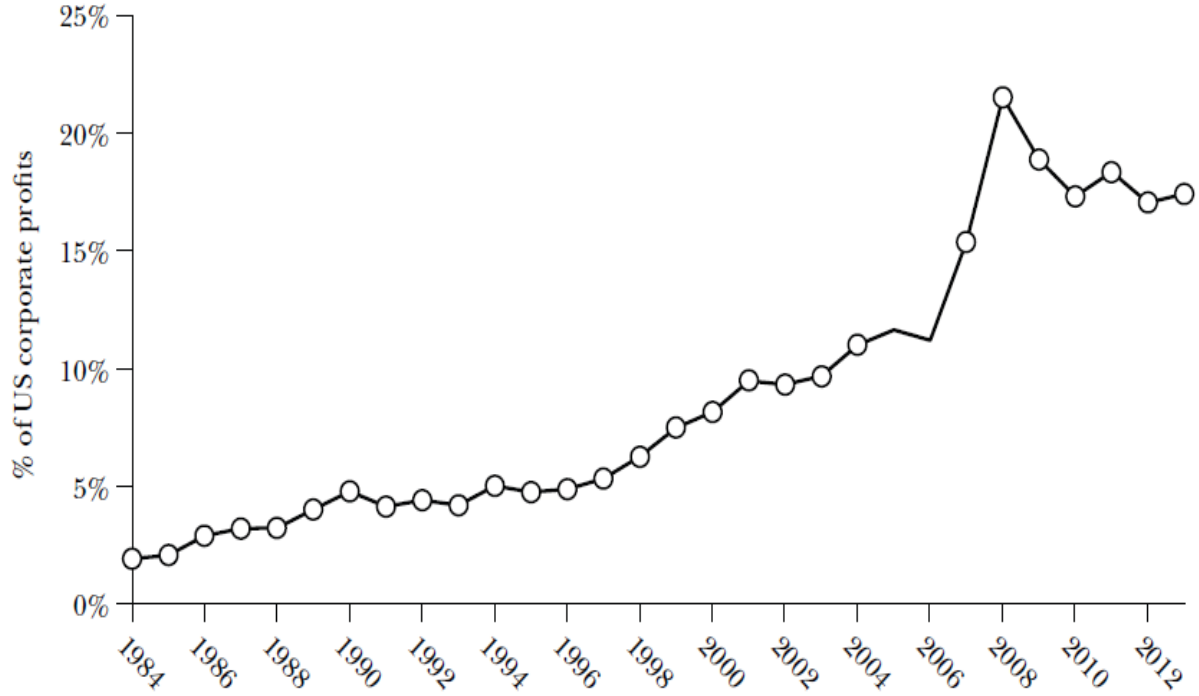
BIG PICTURE AND MOTIVATION

- The equivalent of 10% of the world's GDP is held in tax havens globally (Zucman QJE 2013; Pellegrini et al 2016)
- The share of tax havens in the US corporate profits (Zucman JEP 2014)



  - Profit-shifting to low-tax jurisdictions is estimated to reduce the tax bill of US-owned companies by about 20%

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THIS PAPER

- Authors pose a great question:
  - Effects of the use of *secret* offshore vehicles on firm value

- Question by nature fundamentally hard to study
  - Exploit micro-data leaked from Mossack Fonseca, a major provider of offshore services (the “Panama Papers”)

- Main findings:
  1. Firms exposed in the leaked data are negatively affected
     - Stock prices drop by 0.7%
     - Lost of value is mainly driven by firms with unobservable (or “secret”) offshore activities
  2. This effect is stronger for tax aggressive firms but also for firms exposed to perceptively corrupt countries
  3. Further analyses suggest that firms use offshore shelters to expropriate shareholders

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IMPORTANCE OF THE RESULTS

- "Much cleaner" experiment
  - This leak is valuable as it can be seen as a random event
  - This leak is valuable as it involves a prominent, representative provider of offshore financial services

- Tax haven sheltering is used *beyond* tax avoidance/evasion:
  - Finance corruption
  - Expropriate shareholders

- Can disentangle the impact of secret (or illegal) activities from observable (legal?) activities

- Critical for (tax) authorities to better target their enforcement effort

COMMENTS

1. Interpretation of the results

2. Empirical results
   - Unobserved characteristics
   - Where does the effect come from?

3. Welfare implications

✓ Nice and timely analysis of the role of offshore shelters on value creation

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INTERPRETATION

- Various channels can account for the documented market reaction:
  1. Tax evasion
  2. Bribe payments
  3. Expropriation costs

- Other potential channels:
  1. Reputational costs
  2. Revelation of the existence of agency issues
     - Strong managerial incentives (based on compensation schemes) to bribe and evade tax (not to extract resources but to increase profits) → investors don't want/expect that in the first place
     - Bribery/tax evasion not used to extract resources but to ↑ firm profits
  3. (Temporary) unattractiveness of "exposed" stocks
     - Investors disregard these stocks and sell them (if they hold some)

- These other channels are consistent with the documented evidence, especially on governance (e.g. many aspects of reputation strongly correlate with the governance proxies), and thus should be discussed

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INTERPRETATION (2)

- All the channels explored in the paper relate to the secret (or illegal) nature of the use of offshore vehicles
  - i.e. disguise business ownership from law enforcement or the public

- But shell companies are not all necessarily illegal

- The effect is more pronounced for exposure of secret activities (this is crucial)
  - What is the fraction of firms with exposure to secret activities, please provide summary stat → difficult to interpret economically the effect

- Why don't the authors instead focus on the effect for firms exposed to secret activities when it comes to investigate the channels?
  - Apply triple difference models in Tables 7, 8 and 9
  - This would allow to better pin down the 3 channels and to rule out the other potential channels (at least the unattractiveness of exposed stocks story)

INTERPRETATION (3)

- Provide additional analyses (but still need to wait ☺):
  - Explore long-term stock performance
  - Study actual enforcement and fines imposed

EMPIRICAL RESULTS

- Firms may experience negative returns for reasons related to other characteristics but unrelated to the leaked data

  - Regression models “only” control for size in addition to country and industry FEs
    - Matching procedures should be apply to much more observable characteristics, especially given the size of the control group
      - i.e. matching on firm-level characteristics of Table 2 + risk and profitability measures

  - Complex firms may be adversely affected around the leak because investors factor in a larger premium for complexity
    - Table 2 shows that exposed firms significantly differ along related dimensions (nb of subsidiaries etc.)
    - Look at firms that are more complex in terms of organizational and ownership structure as a counterfactual

EMPIRICAL RESULTS (2)

- The authors focus on 3 key dates:
  1. **April 3:** news organizations start reporting the leak
  2. **April 26:** ICIJ announces that the leaked data will be made public
  3. **May 9:** the database is made public

	(1)	(2)	(3)
Dependent variable	Alpha	Alpha	Alpha
Event days	Day 1	Day 2	Day 3
Has Panama Papers Exposure	-0.156	-0.408*	-0.142
	(-0.87)	(-1.66)	(-1.16)

- Why does April 26 capture most of the significant negative stock price effect?
  - I would have expected rather April 3 (first leak) or May 9 (disclosure of who is involved)
  - Provide more evidence on market reaction around dates (various event windows and placebo dates)

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EMPIRICAL RESULTS (3)

- Is the effect only specific to Panama Papers?

- It would be interesting to investigate whether firms exposed e.g. to the leak from HSBC Switzerland (the “Swiss Leaks”) experienced similar value destruction?
  - In 2007, an HSBC Private Bank employee extracted the complete internal records of more than 30,000 clients
  - The list contains the name of the beneficial owners of the wealth the bank managed, even when this wealth was held via shell companies
  - The newspaper *Le Monde* obtained a version of the data obtained from the French tax authority and shared it with the ICIJ
  - ICIJ assembled a global team of journalists and in January 2015 published the results of its investigation, called “Swiss Leaks”
  - Data source: https://projects.icij.org/swiss-leaks/

WELFARE IMPLICATIONS

- There is a tradeoff with the use of secret offshore vehicles (Desai, Dyck and Zingales JFE 2007)
  - Tax evasion and bribe (create value)
  - Diversion of corporate resources by insiders (reduce value)

- The paper makes progress in separating these effects but doesn't discuss them economically
  - I would discuss more the inter-connections b/w those effects and which one dominates
  - This has important implications, especially for regulations and enforcement actions

- Try to better relate your findings to the debate on the costs of tax havens
  - In particular, relate your numbers ($135 B) to the recent and precise numbers in Zucman (2013, 2014)
  - Give an idea of the transfer b/w exposed firms' shareholders and government or other stakeholders?

CONCLUSION

- Very nice and interesting reading
- Very fast execution
  - First version April 19
  - Recall that the first leak occurred on April 3!
- Strengthen the identification of the channels by addressing other potential channels
- Focus more on secret exposure (key finding) and provide further evidence on market reaction around the leaks
- Improve the discussions on the economic impact and welfare implications of offshore secrets
- Good luck with the paper!

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